COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE TARIFF APPLICATION OF GTE SOUTH, INC. (ACCESS SERVICES)) CASE NO. 10171

TABLE OF CONTENTS

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O R D E R

INTRODUCTION

Procedural Background

On January 26, 1988, GTE South, Inc. ("GTE"), filed a revised access services tariff with the Commission. The effect of the tariff filing was to increase GTE's access services revenues. On February 29, 1988, the tariff filing was suspended for investigation. On May 6, 1988, an informal conference was held to identify issues that could not be resolved short of formal hearing.[1]

In addition to GTE, AT&T Communications of the South Central States Inc. ("AT&T"), the Attorney General of the Commonwealth of Kentucky, by and through his Utility and Rate Intervention Division ("Attorney General"), and MCI Telecommunications Corporation ("MCI") participated in this investigation.

The Commission received prefiled testimony as follows:

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1 The informal conference was originally scheduled on March 30, 1988, and was rescheduled to accommodate those needing to attend.

1. On behalf of AT&T, prefiled testimony of L. G. Sather, Staff Manager, Marketing Plans Implementation, filed on July 1, 1988.

2. On behalf of GTE, prefiled testimony of Carol C. Guthrie, Revenue Results Manager, filed on July 1, 1988.

3. Also on behalf of GTE, prefiled testimony of Douglas E. Wellemeyer, Pricing and Tariffs Manager, filed on July 1, 1988.

A public hearing was held on July 6, 1988 to permit the presentation of testimony and the cross-examination of witnesses. The resulting Transcript of Evidence was filed on July 12, 1988.

At the hearing, GTE made a motion requesting that information concerning intraLATA minutes of use for certain interLATA carrier services be incorporated into this record if the Commission were going to consider the information in its deliberations. Such information was not considered in formulating the Commission's decision and, therefore, the motion is moot.[2]

The Commission received post hearing briefs as follows:

1. Brief of AT&T, filed on July 15, 1988.

2. Brief of the Attorney General, filed on July 18, 1988.

3. Brief of GTE, filed on July 15, 1988.

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2 Transcript of Evidence, page 196.

DISCUSSION

Policy Positions on Access Charges

The subject of interLATA[3] cost of service recurs throughout Commission Orders in Case No. 8838.[4] For example, in Phase I, the Commission found that "each local exchange carrier should develop company-specific cost information."[5] Subsequently, on reconsideration, the Commission reinforced its position, noting that "intrastate access services cost information is essential and must be developed."[6] Furthermore, in Phase IV, the Commission concluded that "any local exchange carrier that seeks to increase access charges must file an analysis of interLATA cost of service with its application."[7] In each of these instances, the

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3 Local Access and Transport Area.

4 An Investigation of Toll and Access Charge Pricing and Toll Settlement Agreements for Telephone Utilities Pursuant to Changes to be Effective January 1, 1984.

5 Order in Case No. 8838, Phase I, dated November 20, 1984, page 85. It should be noted that the discussion of interLATA cost of service contained in this Order refers to a separations based information system then under development by Bell Communications Research. See discussion at pages 83-85.

6 Order in Case No. 8838, Phase I, dated February 15, 1985, page 70. It should be noted that the discussion of interLATA cost of service contained in this Order refers to "cost separations studies." See discussion at pages 68-71.

7 Order in Case No. 8838, Phase IV, dated December 9, 1987, page 18. It should be noted that in this investigation the Commission granted an AT&T Motion to Compel Continental Telephone Company of Kentucky to provide information on interLATA cost of service that was based on Federal Communications Commission ("FCC") Part 67 Separations Procedures and Part 69 Access Charges rules and regulations.

Commission intended that interLATA cost of service information be based on FCC separations procedures and FCC access charges rules.

The Phase IV Order in Case No. 8838 established various conditions relative to access services tariff filings. These conditions and the underlying rationale go to the substance of this investigation. Therefore, a brief review is in order.

The Commission initiated Phase IV to reconsider interLATA and ULAS[8] compensation.[9] Among the outcomes of the investigation was a decision to freeze interLATA revenue requirements at 1984 levels until such time as local exchange carriers could demonstrate changed revenue requirements through cost of service information.[10] Although the Commission did not specify that it contemplated interLATA cost of service information based on FCC separations procedures and FCC access charges rules, the Commission's expectations were implied. For example, the Commission observed that:

> . . . the rates under consideration in this investigation are based on FCC access charge rules and regulations, which are designed to identify, allocate, and recover relevant costs. Furthermore, there is evidence in the record to suggest that intrastate cost of service may not substantially vary from interstate

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8 Universal Local Access Service.

9 InterLATA and ULAS compensation were originally considered in Orders in Case No. 8838, Phase I, dated November 20, 1984, and Phase II, dated May 31, 1985.

10 Order in Case No. 8838, Phase IV, dated December 9, 1987, page 8 and passim.

> cost of service. Therefore, pending the development of intrastate cost of service information, access charges based on FCC rules and regulations are acceptable.[11]

Also, elsewhere in the same Order:

> . . . the access service rates proposed in this case reflect mid-year 1986 interstate access service rates developed under FCC access charge rules and regulations, which require access service rates based on fully distributed cost. Therefore, these rates are acceptable to the Commission.[12]

Although these citations refer to rates and not revenue requirements, the relevant points are the references to FCC rules and regulations. Moreover, the clarification in this Order should serve as notice to GTE and other local exchange and interLATA carriers that interLATA cost of service information and access charges should be based on relevant FCC rules and regulations.

In addition to addressing interLATA and ULAS compensation and revenue requirements, the Phase IV Order in Case No. 8838 established optional access services tariff filing procedures.[13] Specifically, local exchange carriers were authorized to make annual intrastate access services tariff filings that mirror their interstate access services tariffs as approved by the FCC. This decision was based on the presumption that there is no significant difference in jurisdictional cost of service[14] and the requirement that local exchange carriers file interLATA cost of service

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[11] Ibid., page 6, footnote omitted.

[12] Ibid., page 18.

[13] Ibid., pages 25-28.

[14] Ibid., page 17 and *passim*.

information along with any application to increase access charges or revenue requirements.[15]

Clearly, when the Commission authorized local exchange carriers to make annual intrastate access services tariff filings, it did not intend to foreclose the need to require non-mirrored adjustments that satisfy revenue requirements or accomplish the Commission's regulatory policy goals of equity, efficiency, and universal service. In fact, in the Phase IV Order in Case No. 8838, the Commission ordered one local exchange carrier to reduce proposed intrastate switched access services rates because it would have exceeded its revenue requirements with a mirror of interstate switched access services rates.[16] Also, the Commission ordered all local exchange carriers to modify their access services tariffs to comply with its Order concerning jurisdictional Wide Area Telecommunications Service ("WATS").[17] Therefore, local exchange carriers were authorized to make annual intrastate access services tariff filings that mirror their interstate access services tariffs as approved by the FCC to the maximum extent possible consistent with their revenue requirements and the Commission's regulatory policy goals of equity, efficiency, and universal service.

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15 Ibid., page 18 and passim.

16 Ibid., page 13.

17 Ibid., page 24.

Finally, the Phase IV Order in Case No. 8838 reaffirmed the Commission's intention to gradually mirror-down or reduce carrier common line charges[18] and defined ULAS as a residual of non-traffic sensitive revenue requirement.[19]

The Tariff Filing

The access services tariff filing under consideration in this investigation is an intrastate mirror of GTE's interstate access services tariff with three exceptions.[20] First, billing and collection services rates are not mirrored.[21] Instead, the billing and collection services rates contained in the tariff filing reflect rates agreed to in a contract between AT&T and GTE for intrastate bill processing, collection, and recording services.[22] Second, rates for premium and non-premium switched transport terminations are not mirrored.[23] Instead, switched transport termination rates were adjusted to levels below mirrored

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18 Ibid., pages 20-21.

19 Ibid., page 10.

20 The rates contained in the tariff filing mirror rates in GTE's FCC Tariff No. 1, which was allowed to become effective on January 1, 1988.

21 Prefiled testimony of Mr. Wellemeyer, page 9, Transcript of Evidence, page 21, and Brief of GTE, page 8.

22 The rates contained in the contract were filed with the Commission on July 31, 1987, and allowed to become effective on February 1, 1988, by Order dated January 28, 1988, in Case No. 10006, The Tariff Filing of General Telephone Company of the South to Reduce Bill Processing and Collection Services Rates.

23 Prefiled testimony of Mr. Wellemeyer, pages 9-11, Transcript of Evidence, page 21, and Brief of GTE, pages 8-9.

rates in order to match access services revenues with revenue requirements. Third, carrier common line rates are not mirrored.[24] Instead, the carrier common line rates contained in the tariff filing reflect carrier common line rates approved in the Phase IV Order in Case No. 8838.

AT&T objects to GTE's access services tariff filing on the grounds that (1) it is not supported by adequate interLATA cost of service information, (2) it is not supported by adequate demand forecast and price-out information, and (3) it is not a mirror of GTE's interstate access services tariff.[25] The issues of the interLATA cost of service analysis and the demand forecast and price-out are discussed elsewhere in this Order. On the mirror issue, AT&T contends that GTE's mirroring of its interstate access services tariff presents distorted views[26] and notes that "approximately two-thirds of the revenues to be recovered under

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24 Prefiled testimony of Mr. Wellemeyer, pages 12-15, Transcript of Evidence, pages 21-22, and Brief of GTE, pages 10-11.

25 Brief of AT&T, pages 2-4. AT&T links the mirror concept with both GTE's cost of service analysis and access services tariff. That is, AT&T contends that GTE's intrastate cost of service methodology does not mirror its interstate cost of service methodology and that GTE's intrastate access services tariff does not mirror its interstate access services tariff. For the sake of clarity, in this Order the mirror concept is used relative to access services rates and tariffs.

26 Brief of AT&T, page 3. Also, see Transcript of Evidence, page 24.

the proposed intrastate tariff came from rate elements which differed from or did not exist in the interstate tariff."[27]

GTE indicates that it based its access services tariff filing on its interpretation of the Commission's Phase IV Order in Case No. 8838.[28] GTE contends that it "exercised reasonable care in evaluating the Order and its intent"[29] and filed "a revised access tariff which is in compliance with all known regulatory requirements."[30]

As discussed elsewhere in this Order, the Phase IV Order in Case No. 8838 authorized local exchange carriers to make annual intrastate access services tariff filings that mirror their interstate access services tariffs as approved by the FCC to the maximum extent possible consistent with their revenue requirements and the Commission's regulatory policy goals of equity, efficiency, and universal service. In the opinion of the Commission, GTE's interpretation of the procedures and regulatory policy established in the Phase IV Order in Case No. 8838 is substantially correct. The notable exception to this evaluation is GTE's treatment of carrier common line rates.

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27 Brief of AT&T, page 3. Also, see Transcript of Evidence, pages 23-24. The reference to rate elements that do not exist in the interstate tariff is an apparent reference to ULAS. See Transcript of Evidence, page 23.

28 Prefiled testimony of Mr. Wellemeyer, passim and Transcript of Evidence, page 18.

29 Prefiled testimony of Mr. Wellemeyer, page 19.

30 Ibid.

AT&T's contention that GTE's access services tariff does not meet the mirror standard because approximately two-thirds of the associated revenues result from non-mirrored rate elements is without merit. The Commission interprets the mirror standard to be one of substantial compliance. As stated, non-mirrored rate elements are and will continue to be allowed where reasonable justification exists and whenever revenue requirements or the Commission's regulatory policy necessitate non-mirrored rate elements. In the view of the Commission, GTE's access services tariff filing meets the standard of substantial compliance, except in its treatment of carrier common line rates.

GTE's access services tariff is a several hundred page document which mirrors hundreds of rate elements and terms and conditions of service, as compared to the dozen or so rate elements that are not mirrored. As indicated above, GTE's intrastate access services tariff does not mirror its interstate access services tariff in the areas of billing and collection services, switched transport services, and carrier common line rates. The deviation in the area of billing and collection services is justified due to GTE's contract with AT&T. Also, the deviation in the area of switched transport services is necessary in order to match access services revenues and revenue requirements. In this area, GTE took direction from the Commission's Order in Phase IV of Case No. 8838,[31] wherein the

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31 <u>Ibid.</u>, page 11.

Commission ordered one local exchange carrier to reduce rates for switched access services in order to match access services revenues and revenue requirements.[32] In the view of the Commission, such adjustments should be made in the area of switched access services.

In the area of carrier common line rates, GTE did not file mirrored carrier common line rates based on its interpretation of the Commission's Order in Phase IV of Case No. 8838,[33] wherein the Commission denied recommendations made by the Attorney General on carrier common line [illegible][34] interpretation is not accurate. The Commission rejected the Attorney General's recommendations in Phase IV of Case No. 8838 because adoption would have resulted in a greater increase to ULAS revenue requirement than was otherwise indicated and because adoption would have resulted in non-mirrored carrier common line rates. Consequently, the Commission decided to "continue the past practice of gradually assigning non-traffic sensitive revenue requirement to ULAS as carrier common line charges are reduced."[36] This means that the Commission intends to mirror-down carrier common line rates as carrier common line rates are reduced at the federal level.

Due to GTE's failure to mirror carrier common line rates and decisions made elsewhere in this Order concerning GTE's interLATA cost of service analysis and demand forecast and price-out, the Commission must reject GTE's access services tariff filing. However, upon simultaneous submission of an interLATA cost of service analysis and demand forecast and price-out that are consistent with the provisions of this Order, GTE will be allowed to deviate from the annual access services tariff filing schedule and resubmit a 1988 application.

<u>The Cost of Service Analysis</u>

The interLATA cost of service analysis filed in this investigation forecasts interLATA revenue requirements through December 31, 1988. AT&T objects to GTE's interLATA cost of

36 Order in Case No. 8838, Phase IV, dated December 9, 1987, pages 20-21.

service analysis, generally, on the grounds that AT&T does "not believe GTE's cost study methodology is appropriate."[37] First, AT&T objects to the methodology used by GTE to assign non-traffic sensitive revenue requirement to the interLATA market:

> Our concern is that the method which GTE has used to allocate the non-traffic sensitive revenue requirement discriminates against interexchange carriers and their customers and results in interLATA toll services contributing a disproportionate share based on the relationship of intraLATA toll minutes to interLATA toll minutes.[38]

That is, GTE allocated non-traffic sensitive revenue requirement to the interLATA market based on a subscriber plant factor, and AT&T would prefer an allocation based on subscriber line usage.

Second, AT&T objects to the non-linear relationship between increases in demand units and revenue requirements. AT&T asserts that:

> . . . growth in revenue requirements, year over year, for any particular cost category is, all other factors being equal, a function of two items: the growth in units in service and the growth in cost per unit. Given the low inflation trend in recent years, one would anticipate that the growth in costs would track very closely with the growth in units in service.[39]

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37 Prefiled testimony of Mr. Sather, page 4.

38 Ibid., pages 6-7. Also, see Brief of AT&T, page 12.

39 Prefiled testimony of Mr. Sather, page 7.

AT&T then observes that "this is not the case with GTE's cost of service study."[40] AT&T notes several examples, including that access lines are forecasted to grow approximately 3 percent while carrier common line revenue requirement is forecasted to grow approximately 17 percent, and interLATA minutes of use are forecasted to grow approximately 1 percent while traffic sensitive revenue requirement is forecasted to grow approximately 26 percent.[41]

AT&T's objections to GTE's interLATA cost of service analysis also bear on issues of regulatory policy. At some length, AT&T states:

> The access cost of service study provided by GTE does not represent the economic costs that GTE incurs solely as a function of provisioning access services. The GTE methodology is a fully distributed cost study. First, this methodology allocates all costs of the firm including common costs which cannot be unambiguously allocated to the various services. Second, and more importantly, this methodology assigns non-traffic sensitive cost, which is not a function of the provisioning of toll service, to the toll service category. In so doing, the study is, in effect, presupposing the pricing objectives for toll service. That is, it is indicating the level of subsidy that is desired from toll service not by justifying the level of subsidy but by arbitrarily allocating cost to that service and, therefore, concluding that the prices of the service should cover the cost. To the extent that

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40 Prefiled testimony of Mr. Sather, pages 7-8. Also, see Transcript of Evidence, pages 170-171 and Brief of AT&T, pages 5-7.

41 Ibid.

> there has been no agreement as to the appropriate level of subsidy, this allocation, particularly regarding the Kentucky operations, is totally arbitrary.[42]

Finally, AT&T contends that GTE selectively applied FCC rules and regulations to develop its interLATA cost of service analysis and notes certain technical faults, including alleged errors in the treatment of plant in service and plant under construction.[43]

The position of the Attorney General differs from AT&T in a key area. While AT&T would prefer to allocate non-traffic sensitive revenue requirement to the interLATA market based on subscriber line usage, the Attorney General recommends the use of a subscriber plant factor.[44] Also, like AT&T, the Attorney General notes GTE's apparent inconsistent treatment of plant under construction between intrastate and interstate access services revenue requirements applications.[45]

MCI supports AT&T's position concerning the allocation of non-traffic sensitive revenue requirement to the interLATA market. Specifically, MCI argues that "the Commission should not permit a disproportional recovery of the non-traffic sensitive revenue

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42 Prefiled testimony of Mr. Sather, page 20. Also, see Transcript of Evidence, page 170.

43 Prefiled testimony of Mr. Sather, pages 21-22, Transcript of Evidence, pages 144-150, and Brief of AT&T, pages 8-10.

44 Brief of the Attorney General, pages 5-6.

45 Ibid., pages 6-7.

CORRECTION

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PRECEDING IMAGE HAS BEEN REFILMED TO ASSURE LEGIBILITY OR TO CORRECT A POSSIBLE ERROR

AT&T's contention that GTE's access services tariff does not meet the mirror standard because approximately two-thirds of the associated revenues result from non-mirrored rate elements is without merit. The Commission interprets the mirror standard to be one of substantial compliance. As stated, non-mirrored rate elements are and will continue to be allowed where reasonable justification exists and whenever revenue requirements or the Commission's regulatory policy necessitate non-mirrored rate elements. In the view of the Commission, GTE's access services tariff filing meets the standard of substantial compliance, except in its treatment of carrier common line rates.

GTE's access services tariff is a several hundred page document which mirrors hundreds of rate elements and terms and conditions of service, as compared to the dozen or so rate elements that are not mirrored. As indicated above, GTE's intrastate access services tariff does not mirror its interstate access services tariff in the areas of billing and collection services, switched transport services, and carrier common line rates. The deviation in the area of billing and collection services is justified due to GTE's contract with AT&T. Also, the deviation in the area of switched transport services is necessary in order to match access services revenues and revenue requirements. In this area, GTE took direction from the Commission's Order in Phase IV of Case No. 8838,[31] wherein the

[31] Ibid., page 11.

Commission ordered one local exchange carrier to reduce rates for switched access services in order to match access services revenues and revenue requirements.[32] In the view of the Commission, such adjustments should be made in the area of switched access services.

In the area of carrier common line rates, GTE did not file mirrored carrier common line rates based on its interpretation of the Commission's Order in Phase IV of Case No. 8838,[33] wherein the Commission denied recommendations made by the Attorney General on carrier common line rates.[34] GTE's interpretation of the Commission's action is that carrier common line rates should not be mirrored-down when a significant increase in ULAS revenue requirement will result, as would occur in this case.[35] This

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32 Order in Case No. 8838, Phase IV, dated December 9, 1987, page 13.

33 Prefiled testimony of Mr. Wellemeyer, pages 12-13, Transcript of Evidence, pages 21-22, and Brief of GTE, pages 10-11.

34 Order in Case No. 8838, Phase IV, dated December 9, 1987, pages 20-21. The recommendations made by the Attorney General were that, first, the originating carrier common line rate be reduced to zero and, subsequently, that both originating and terminating carrier common line rates be eliminated.

35 GTE based its interpretation of the Commission's intent on the statement that "adoption of either of the Attorney General's recommendations would result in a sudden and dramatic increase in required ULAS compensation, at a time when other investigations concerning ULAS are under way." Order in Case No. 8838, Phase IV, dated December 9, 1987, page 20. This citation should be viewed in the context of the later discussion linking reductions in intrastate carrier common line charges and increases in ULAS revenue requirement with reductions in interstate carrier common line charges. See the same Order at pages 20-21.

interpretation is not accurate. The Commission rejected the Attorney General's recommendations in Phase IV of Case No. 8838 because adoption would have resulted in a greater increase to ULAS revenue requirement than was otherwise indicated and because adoption would have resulted in non-mirrored carrier common line rates. Consequently, the Commission decided to "continue the past practice of gradually assigning non-traffic sensitive revenue requirement to ULAS as carrier common line charges are reduced."[36] This means that the Commission intends to mirror-down carrier common line rates as carrier common line rates are reduced at the federal level.

Due to GTE's failure to mirror carrier common line rates and decisions made elsewhere in this Order concerning GTE's interLATA cost of service analysis and demand forecast and price-out, the Commission must reject GTE's access services tariff filing. However, upon simultaneous submission of an interLATA cost of service analysis and demand forecast and price-out that are consistent with the provisions of this Order, GTE will be allowed to deviate from the annual access services tariff filing schedule and resubmit a 1988 application.

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[36] Order in Case No. 8838, Phase IV, dated December 9, 1987, pages 20-21.

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That is, GTE allocated non-traffic sensitive revenue requirement to the interLATA market based on a subscriber plant factor, and AT&T would prefer an allocation based on subscriber line usage.

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> . . . growth in revenue requirements, year over year, for any particular cost category is, all other factors being equal, a function of two items: the growth in units in service and the growth in cost per unit. Given the low inflation trend in recent years, one would anticipate that the growth in costs would track very closely with the growth in units in service.[39]

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AT&T's objections to GTE's interLATA cost of service analysis also bear on issues of regulatory policy. At some length, AT&T states:

> The access cost of service study provided by GTE does not represent the economic costs that GTE incurs solely as a function of provisioning access services. The GTE methodology is a fully distributed cost study. First, this methodology allocates all costs of the firm including common costs which cannot be unambiguously allocated to the various services. Second, and more importantly, this methodology assigns non-traffic sensitive cost, which is not a function of the provisioning of toll service, to the toll service category. In so doing, the study is, in effect, presupposing the pricing objectives for toll service. That is, it is indicating the level of subsidy that is desired from toll service not by justifying the level of subsidy but by arbitrarily allocating cost to that service and, therefore, concluding that the prices of the service should cover the cost. To the extent that

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Finally, AT&T contends that GTE selectively applied FCC rules and regulations to develop its interLATA cost of service analysis and notes certain technical faults, including alleged errors in the treatment of plant in service and plant under construction.[43]

The position of the Attorney General differs from AT&T in a key area. While AT&T would prefer to allocate non-traffic sensitive revenue requirement to the interLATA market based on subscriber line usage, the Attorney General recommends the use of a subscriber plant factor.[44] Also, like AT&T, the Attorney General notes GTE's apparent inconsistent treatment of plant under construction between intrastate and interstate access services revenue requirements applications.[45]

MCI supports AT&T's position concerning the allocation of non-traffic sensitive revenue requirement to the interLATA market. Specifically, MCI argues that "the Commission should not permit a disproportional recovery of the non-traffic sensitive revenue

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42 Prefiled testimony of Mr. Sather, page 20. Also, see Transcript of Evidence, page 170.

43 Prefiled testimony of Mr. Sather, pages 21-22, Transcript of Evidence, pages 144-150, and Brief of AT&T, pages 8-10.

44 Brief of the Attorney General, pages 5-6.

45 Ibid., pages 6-7.

requirement between intraLATA and interLATA services"[46] and favors an allocation based on subscriber line usage.

GTE "believes the cost of service study filed in the case to be the most appropriate representation of its costs of providing access service in 1988 currently available."[47] GTE's interLATA cost of service analysis is generally patterned on FCC separations procedures and FCC access charges rules.[48] In addition, the study reflects the capital to expense shift caused by new accounting rules and the appropriate federal tax rate for 1988.[49] The study does not reflect FCC separations procedures changes relating to some categories of central office equipment.[50] Finally, GTE observes that:

> . . . the study was performed according to the fully distributed costing methodology prescribed by the FCC, the only methodology which GTE South has had experience in using to date and which the Commission has had experience in evaluating to date.[51]

As previously indicated in this Order, the Commission has always intended that GTE and other local exchange carriers would file interLATA cost of service information based on FCC

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46 Brief of MCI, page 5.

47 Prefiled testimony of Ms. Guthrie, page 3. Also, see Transcript of Evidence, page 78 and Brief of GTE, page 12.

48 Prefiled testimony of Ms. Guthrie, pages 2-3, Transcript of Evidence, page 78, and Brief of GTE, pages 11-12.

49 Ibid.

50 Ibid.

51 Prefiled testimony of Ms. Guthrie, page 3. Also, see Brief of GTE, page 12.

separations procedures and FCC access charges rules. FCC separations procedures were developed to jurisdictionally allocate investment and expenses. Therefore, it is reasonable to use FCC separations procedures on an intrastate basis to allocate investment and expenses between the interLATA and intraLATA markets, which avoids the need to establish jurisdictionally specific separations procedures. Likewise, FCC access charges rules were developed to guide rate structure. Therefore, in general, it is reasonable to mirror interstate access services tariffs on an intrastate basis and avoid the need to establish jurisdictionally specific access charges rules.

In the opinion of the Commission, to the extent that GTE followed FCC separations procedures and FCC access charges rules to develop its interLATA cost of service analysis and access services tariff filing, GTE complied with the intent of the Commission as expressed in prior Orders.[52] Therefore, AT&T's objection that the methodology is not appropriate is without merit.

FCC separations procedures jurisdictionally allocate non-traffic sensitive cost on the basis of a subscriber plant factor rather than subscriber line usage.[53] Accordingly, in the opinion of the Commission, interLATA cost of service analyses

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52 For example, Orders in Case No. 8838, Phase I, dated November 20, 1984 and February 15, 1985, and Phase IV, dated December 9, 1987.

53 Transcript of Evidence, pages 97-98 and 181-182, and Brief of GTE, page 14.

should allocate intrastate non-traffic sensitive cost on the basis of a subscriber plant factor. This results in a somewhat greater allocation of non-traffic sensitive cost to the interLATA market than would occur with an allocation based on subscriber line usage, but is consistent with prevailing regulatory practice.

AT&T contends that growth in units in service and growth in cost per unit should approximate, all other things equal. This is not the case, even when all other things are equal. AT&T's argument ignores a number of factors. For example, it ignores the fact that investment decisions may cause "cost lumps" relative to any growth in units in service. In other words, a decision to increase production capacity may not be followed by the immediate consumption of that capacity. Furthermore, GTE has demonstrated that all other things are not equal in this case.[54] Various changes in FCC separations procedures have been made since GTE's access services revenue requirement was established in 1984 that tend to shift costs to the intrastate jurisdiction in a way totally apart from increased network usage. Some of these changes

54 Transcript of Evidence, pages 174-178 and Brief of GTE, pages 20-21.

are reflected in GTE's interLATA cost of service analysis. Also, changes in accounting rules have caused capital to expense and other accounting shifts in a way totally apart from increased network usage. As above, some of these changes are reflected in GTE's interLATA cost of service analysis. In summary, all other things are not equal and variance between growth in units in service and growth in cost per unit can be significant.

Lastly, fully distributed cost principles are inherent to FCC separations procedures and FCC access charges rules, and common costs must be allocated in some way. In the opinion of the Commission, allocation of common cost according to fully distributed cost principles is reasonable and consistent with prevailing regulatory practice.

Although the record indicates that GTE generally adhered to FCC separations procedures and FCC access charges rules in developing its interLATA cost of service information, there is also evidence to indicate the selective omission of known rules changes and inadvertent errors that impact access services revenue requirements. For example, GTE did not consider known FCC separations rules changes relating to some categories of central office equipment[55] and did not fully reflect known accounting rules changes.[56] In addition, there are discrepancies between GTE's interstate and intrastate access services revenue

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55 Prefiled testimony of Ms. Guthrie, pages 3-4 and Brief of GTE, pages 12-13.

56 Prefiled testimony of Ms. Guthrie, pages 1-2 and Brief of GTE, page 12.

requirements applications that have not been explained[57] and items have been included in the intrastate rate base that are not permitted in the interstate rate base.[58] Therefore, the Commission must reject GTE's interLATA cost of service analysis as a basis for establishing access services revenue requirements. This decision does not preclude GTE from filing a corrected interLATA cost of service analysis with the Commission at another time.

As is the case with demand forecasts and price-outs, the use of revenue requirements forecasts is consistent with interstate revenue requirements review procedures. Therefore, the decision to reject GTE's interLATA cost of service analysis does not preclude the use of revenue requirements forecasts. Neither does this decision require the use of revenue requirements forecasts. GTE and other local exchange carriers may file either historical revenue requirements or revenue requirements forecasts to support interLATA cost of service analyses. However, as in the case of demand forecasts and price-outs, revenue requirement forecasts must be completely documented and the Commission may order information in an historical test period format on a case by case basis in access services investigations. Also, revenue requirements based on an historical test period must demonstrate

57 Prefiled testimony of Mr. Sather, page 22, Transcript of Evidence, pages 145-147, and Brief of AT&T, pages 8-9.

58 Prefiled testimony of Mr. Sather, page 22, Transcript of Evidence, pages 148-150, and Brief of AT&T, pages 8-9.

that historical investment and expense trends are reflective of future investment and expense trends.

The Demand Forecast and Price-out

The demand forecast and price-out filed in this investigation forecast demand and revenues for access services through December 31, 1988. AT&T objects to the demand forecast and price-out on the grounds that it includes demand growth estimates that are unreasonably conservative. AT&T states:

> GTE's figures indicate an annual growth in traffic sensitive access minutes for 1988 over 1987 of approximately 1 percent. The growth rate for 1987 over 1986 was approximately 11 percent. A change in growth rate of this magnitude demands detailed justification. None is provided in the data available to AT&T. This growth rate is also inconsistent with the 10.6 percent growth in 1988 access minutes which GTE has forecasted for its Kentucky interstate operations.[59]

Also, AT&T observes that the intrastate demand forecast and price-out was adjusted and that GTE could not explain the basis for the adjustment, except "to claim the possible effect of certain interstate offerings."[60] AT&T recommends that the Commission:

> . . . recalculate the demand quantities. By comparing historic billed access minutes, an 11 percent growth rate is more reasonable than Mr. Wellemeyer's 1 percent.

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59 Prefiled testimony of Mr. Sather, page 9. Also, see Transcript of Evidence, pages 43-64 and Brief of AT&T, pages 7-8.

60 Brief of AT&T, page 8. The interstate offerings are services that use special access services and avoid switched access charges at either the originating or terminating access point. AT&T Megacom service is an example. See Transcript of Evidence, pages 45-53.

> A failure to adjust demand units will result in a windfall for GTE. If volumes are understated by 10 percent, at a minimum, carrier common line revenues will be understated by $.5 million and traffic sensitive revenues by $.7 million. This manipulation of projected versus historic volumes would mean the combined over collection of non-traffic sensitive and traffic sensitive revenues by more than $1.2 million. Such a result should not be permitted.[61]

The Attorney General also objects to GTE's demand forecast and price-out information. The Attorney General states:

> . . . the evidence shows that actual access volumes are increasing at a rate much greater than projected by the company. The historical growth rate for some access volumes is 11 percent or more but the company projected growth is only slightly over 1 percent.[62]

Like AT&T, the Attorney General observes that although "the company tried to explain away this discrepancy by waving the special access bypass flag, it could not substantiate this claim"[63] and "doesn't know why the forecast projects such a low growth rate."[64] Also, the Attorney General notes that the demand forecast and price-out "could portend substantial overrecovery of revenues if the Commission accepts the low projected volumes put forth by the company."[65]

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61 Brief of AT&T, page 8. Also, see prefiled testimony of Mr. Sather, page 10.

62 Brief of the Attorney General, page 3, footnote omitted.

63 Ibid.

64 Ibid.

65 Ibid.

As with AT&T and the Attorney General, MCI objects to GTE's demand forecast and price-out analysis, stating only that "the growth rates used by GTE in its access cost of service study appear to be questionable."[66]

In general, GTE indicates that its demand forecast and price-out estimates are based on its analysis of the interLATA market, including an evaluation of the demand for access services resulting from the introduction of service offerings that use special access services and avoid switched access charges at either the originating or terminating access point.[67] For example, in explaining the difference between an actual demand growth of approximately 11 percent in 1987 and the 1988 demand growth forecast of approximately 1 percent, on cross-examination Mr. Wellemeyer stated:

> I can't attribute specific minutes to particular changes between '87 and '88. I do know that we rationalize it, if you will, as an effect of service bypass on the special access side, but more prominently the introduction of bulk switched access services, such as Megacom, Megacom 800, Prism and UltraWATS.[68]

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66 Brief of MCI, page 6. It is not clear whether MCI is referring to growth estimates used to forecast revenue requirement or demand for access services. In either case, as the Commission reads MCI's Brief, the objection would be the same.

67 Brief of GTE, pages 21-22 and Transcript of Evidence, pages 45-53.

68 Transcript of Evidence, page 46.

However, at a later point, Mr. Wellemeyer admitted that no study or data analysis existed to support the destimulation of historical demand growth patterns[69] and that he did not know the basis for the adjustment.[70]

Clearly, on whatever basis, GTE believes that the introduction of service offerings that use special access and avoid switched access charges at either the originating or terminating access point will destimulate demand for access services. Moreover, there is some evidence in the record to support that contention. On cross-examination, Mr. Wellemeyer stated:

> If we look at the data for 1987, 12 months ended fourth quarter '87, and you strike a trend line through those data, that results in an annual growth rate which is similar to what you have cited. And I believe when you compared '87 and '86 year end amounts, that indicated an 11.15 percent growth rate. And a trend through that same data indicates something even higher, it is 11.8 percent on an annual basis. Now, if we look at the 12 months ended in the first quarter of '88, again, trying to establish what the trend is through those 12 months, the annual growth rate has fallen to 5.3 percent. I don't have complete data for second quarter of '88, but if you complete the same kind of an exercise for the 12 months that ended May, the most current month we have data available for, the annual growth rate has fallen even farther. It has fallen to 1.2 percent. Now, all of these are based on the most recent 12 months of actual data. I don't have explanations or even rationalizations for how this has happened, but we will

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69 Ibid., pages 47 and 52.

70 Ibid., pages 48 and 52.

be developing that before the end of this year. That's a significant turn down in the rate of growth in minutes.[71]

The demand forecast and price-out is crucial to this investigation. If demand for access services is either overstated or understated, then GTE will not obtain the access services revenues that the demand price-out predicts.[72] If demand is overstated, access services revenues will be less than revenue requirements. If demand is understated, access services revenues will exceed revenue requirements. This dilemma highlights the fundamental problem associated with the use of demand forecasts and price-outs. At the same time, the trend line analysis discussed above highlights the basic problem associated with the use of historical demand patterns. That is, like a price-out based on a demand forecast, a price-out based on historical demand patterns will either overstate or understate access services revenues relative to revenue requirements, unless historical demand reflects future demand. Therefore, a reasonable balance must be made between the use of either approach and judgments must be made concerning the validity of the results.

Despite the direction of the trend line analysis discussed above and its apparent correlation with GTE's demand growth estimates, considerable doubt surrounds GTE's demand forecast and

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71 Ibid., pages 55-56.

72 Ibid., pages 33-35. This problem is compounded in this investigation because access services revenue requirements are also forecasted, making it more difficult to design rates that obtain desired outcomes.

price-out. For example, there appears to be significant and unexplained discrepancies between Commission filed and FCC filed Kentucky jurisdictional demand growth estimates.[73] Also, the growth estimates used in the intrastate demand forecast represent a significant departure from historical demand growth patterns and are not supported by an econometric or other analysis that might explain the destimulation of demand for access services. Therefore, the Commission will reject GTE's demand forecast and price-out. This does not mean that the Commission is rejecting the use of demand forecasts and price-outs to predict access services revenues. It does mean that local exchange carriers should file econometric or other analyses along with demand forecasts and price-outs. These analyses should explain the assumptions and methodology underlying demand forecasts and provide better support for price-outs based on demand forecasts.

The use of demand forecasts and price-outs on an intrastate basis is consistent with interstate access services tariff filing review procedures. However, although the Commission will permit the use of demand forecasts and price-outs to predict access services revenues, it is not requiring the use of demand forecasts and price-outs. GTE and other local exchange carriers may also use historical demand patterns to predict access services revenues. Also, the Commission may order historical demand patterns on a case by case basis in access services

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73 Transcript of Evidence, pages 60-63 and Brief of AT&T, pages 7-8.

investigations. Furthermore, as with demand forecasts and price-outs, GTE and other local exchange carriers that use historical demand patterns to predict access services revenues will be required to demonstrate that historical demand reflects future demand.

Rate of Return

GTE's interLATA cost of service analysis includes a 12 percent rate of return on investment, which is GTE's authorized rate of return on interstate investment. AT&T objects to a 12 percent rate of return on investment and contends that GTE's 10.61 percent authorized rate of return on intrastate investment is more appropriate. AT&T states:

> GTE has an authorized rate of return, i.e., a cost of capital, for its overall intrastate operations in Kentucky. This figure is currently 10.61 percent. The cost of capital associated with the provision of access services is the same as it is for all other intrastate services. However, GTE has used 12 percent in the development of its access costs instead of its authorized 10.61 percent. Using this inflated cost of capital merely overstates the revenue requirement for access relative to other services.[74]

Elsewhere, AT&T reiterates its position and observes that 12 percent is the authorized interstate rate of return on investment for all local exchange carriers. Therefore, it:

> . . . includes an analysis of local exchange carriers throughout the country. It is in no way related to the risks or investor expectations associated with GTE's

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74 Prefiled testimony of Mr. Sather, pages 5-6. It should be noted that rate of return on investment and cost of capital are not equivalent terms. See Transcript of Evidence, page 114.

Kentucky operations. Since access is a tariffed service provided by GTE on an intrastate basis, the cost of capital associated with access should be no different than is allowed for it's other intrastate services. Using an inflated return merely overstates GTE's revenue requirement for access as related to other services.[75]

The Attorney General's position is that a 12 percent rate of return on investment is preferable to a 10.61 percent rate of return, because a 12 percent rate of return is more consistent with the goal of universal service.[76] Also, the Attorney General contends that a reduction in rate of return on investment from 12.75 percent to 10.61 percent would not be consistent with the principle of rate gradualism.[77]

MCI supports AT&T's position, stating:

The cost of capital associated with the provision of access service, private line, intraLATA toll and other services should be the same. GTE, however, choose to use a figure of 12 percent instead of its authorized 10.61 percent. By using this inflated cost of capital, GTE has effectively overstated its revenue requirement for access as it compares to other services.[78]

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75 Brief of AT&T, page 11. Also, see Transcript of Evidence, page 193.

76 Transcript of Evidence, pages 80-83 and Brief of the Attorney General, page 5.

77 Brief of the Attorney General, page 5. Access services tariffs that were allowed to become effective in Case No. 8838, Phase I and Phase IV, included a 12.75 percent rate of return on investment, which was the authorized rate of return on interstate investment during the study periods in which the tariffs were developed. The authorized rate of return on interstate investment was reduced to 12 percent effective January 1, 1987.

78 Brief of MCI, page 5.

GTE indicates that it used a 12 percent rate of return on investment in its interLATA cost of service analysis based on its interpretation of past actions by the Commission. For example, GTE states:

> . . . the Commission's Order of December 9, 1987, in Case No. 8838 authorized the mirroring of federal access tariffs, and the rate of return authorized for use in the federal tariff is 12 percent. It is the Company's interpretation that this action by the Commission implicitly established the measure of contribution that intrastate access charges should make to total intrastate revenue sources.[79]

GTE adds:

> To further support this interpretation by the Company, in a previous Order in Case No. 8838,[80] the Commission established an intrastate interLATA revenue requirement for GTE South . . . that revenue requirement was based on a cost of service study which was developed using the then interstate allowed rate of return of 12.75 percent.[81]

GTE's interpretation of the Commission's intent is correct. On November 20, 1984, in Phase I of Case No. 8838, and on December 9, 1987, in Phase IV of Case No. 8838, the Commission allowed access services tariffs to become effective on an intrastate basis. In most cases, these access services tariffs mirrored

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79 Prefiled testimony of Ms. Guthrie, page 5. Also, see Transcript of Evidence, pages 78-79 and passim, and Brief of GTE, pages 13 and 18.

80 This reference is most likely to the Phase I Order dated November 20, 1984, but could also include reference to the Phase II Order dated May 31, 1985.

81 Prefiled testimony of Ms. Guthrie, page 6. Also, see Transcript of Evidence, pages 78-79 and passim, and Brief of GTE, page 14.

interstate access services tariffs with little or no variation and included a 12.75 percent rate of return on investment, which was the authorized rate of return on interstate investment at the time the tariffs were developed. The actual rate of return on intrastate investment no doubt differed from 12.75 percent due to differences in jurisdictional rate bases and may have exceeded 12.75 percent in some cases.[82] In any event, through mirroring interstate access services tariffs on an intrastate basis, the Commission at least implicitly adopted the authorized rate of return on interstate investment as a reasonable surrogate for a jurisdictionally specific rate of return.

In the past, mirrored access services tariffs have been filed with the Commission with the authorized rate of return on interstate investment embedded in rate design. The Commission has approved or modified these tariff filings based on evaluations of authorized revenue requirements, demand price-out information, and the Commission's regulatory policy goals of equity, efficiency, and universal service. The unique feature of GTE's access services tariff filing is the application of the authorized rate of return on interstate investment to interLATA rate base in order to arrive at a total revenue requirement. Furthermore, GTE

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82 To support this judgment, the Commission will cite generally declining costs in the telecommunications industry coupled with growth in the interLATA market, carrier common line charges adjustments to access services tariffs in 1984 and adjustments to switched access services in 1987, and the overall earnings enjoyed by local exchange carriers since divestiture.

adjusted switched access rates to levels below interstate switched access rates to match revenues and revenue requirements. The Commission anticipates that other local exchange carriers will follow similar procedures in the future.

The objections of AT&T and MCI are not persuasive. First, as noted during the hearing in this case, the FCC has extensive experience in the area of access charges, including experience in evaluating the costs and risks associated with providing access services.[83] Consequently, an investigation to determine a generic or case specific rates of return on investment for intrastate access services would be an unnecessary duplication of effort, as the outcome would likely be substantially the same as the federal outcome. Therefore, substitution of the authorized rate of return on interstate investment for a jurisdictionally specific or local exchange carrier specific rate of return on access services is reasonable. Second, the costs and risks associated with providing various telecommunications services are not the same. The costs and risks associated with providing interLATA access services are not the same as the costs and risks associated with providing intraLATA toll services, which are not the same as the costs and risks associated with providing private line services, and so on.[84] Consequently, these and other categories of

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83 Transcript of Evidence, pages 180-181.

84 On the relative costs and contributions produced by interLATA access services and intraLATA toll services, see Transcript of Evidence, pages 183-192.

telecommunications services should not yield the same rate of return on investment. In fact, the Commission does not set rates in order that each rate element or category of telecommunications service yields the same rate of return on investment. Within the context of overall revenue requirements, the Commission may order some rates that yield a large rate of return on investment and others that yield a small or no rate of return on investment, depending on market conditions and the Commisson's regulatory policy goals of equity, efficiency, and universal service. The practice of pricing goods and services or setting rates that yield different rates of return on investment is common both in private enterprise and public utility regulation. In the view of the Commission, this practice is reasonable and does not unduly prejudice any consumer of telecommunications service, including consumers of access services.

InterLATA Lease Agreements

GTE's interLATA cost of service analysis includes revenue requirement associated with the lease of services and network facilities to AT&T.[85] The method used to allocate the cost of these services and network facilities to the interLATA market is based on a contractual agreement between GTE and AT&T.[86] In general, the method follows FCC separations procedures, except

85 Prefiled testimony of Ms. Guthrie, pages 8-10 and Brief of GTE, pages 15-17.

86 Prefiled testimony of Ms. Guthrie, pages 8-9 and Brief of GTE, pages 15-16.

that plant under construction is not allocated to the interLATA market.[87]

In the opinion of the Commission, revenue requirement associated with interLATA lease agreements should be a component of overall access services revenue requirements, as the related services and facilities are dedicated to the interLATA market. However, GTE's demand forecast and price-out do not include revenues associated with interLATA lease agreements.[88] Instead, the revenue requirement associated with interLATA lease agreements is substituted for revenues, evidently on the presumption that revenues and revenue requirement are equal. GTE explains as follows:

> The expected interexchange lease revenues have not been included in establishing a target level of access revenues for several reasons. First, the method used by the Company serves to specifically identify a requirement for access and to target that requirement as the level of revenue to be generated by access services . . . A further justification for the Company's methodology is that interexchange lease termination dates change frequently. Therefore, what is expected currently as the level of interexchange lease revenue to be paid by AT&T in 1988 may turn out to be somewhat less.[89]

Despite this explanation, GTE offered no proof that revenues associated with interLATA lease agreements would be less than revenue requirement. Also, GTE offered no proof that revenues

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87 Ibid.

88 Prefiled testimony of Ms. Guthrie, pages 9-10 and Brief of GTE, pages 16-17.

89 Brief of GTE, pages 16-17.

associated with interLATA lease agreements would equal revenue requirement. Finally, at least in theory, revenues associated with interLATA lease agreements could exceed revenue requirement.

In the opinion of the Commission, revenues associated with interLATA lease agreements and not revenue requirement should be reflected in GTE's demand forecast and price-out. In fact, the Commission has ordered that revenues associated with interLATA lease agreements should be considered a part of overall access services revenues.[90]

GTE's interLATA lease agreement with AT&T provides for compensation to GTE in the event that AT&T terminates a lease arrangement prior to the scheduled termination date.[91] GTE did not include early termination payments on interLATA lease agreements in its demand forecast and price-out.[92] In the opinion of the Commission, early termination payments on interLATA lease agreements should be considered a part of overall access services revenues, as the payments relate to the provision of interLATA services.

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90 Order in Case No. 8998, Application of General Telephone Company of Kentucky for Approval of the Lease of Certain Property to AT&T Communications of the South Central States, Inc., dated June 17, 1985, page 1.

91 Prefiled testimony of Mr. Sather, pages 14-15, Transcript of Evidence, page 133, Brief of AT&T, page 13, Brief of the Attorney General, page 6, Brief of GTE, pages 22-23, and Brief of MCI, page 6.

92 Transcript of Evidence, pages 136-137.

The accounting and revenue requirement treatment accorded to stranded investment associated with interLATA lease agreements is not clear.[93] To some extent, it appears that stranded investment associated with interLATA lease agreements is reassigned to other uses.[94] For example, during the hearing, GTE indicated that investment associated with interLATA lease agreement terminations was reassigned to other areas of interLATA use or to the intraLATA toll market, if possible. In response to cross-examination, Ms. Guthrie stated that "when AT&T terminates a lease--of interexchange plant, it is sometimes possible to reuse or migrate part of that plant for use in the access or toll jurisdictions."[95] However, Ms. Guthrie was not able to quantify the amount of any such migration or reuse. Based on Ms. Guthrie's testimony, the Commission is concerned that unnecessary reassignments to the intraLATA market could occur.

In other instances, it appears that stranded investment associated with interLATA lease agreements that cannot be reassigned is retired.[96] For example, in response to an information request, GTE stated:

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93 Ibid., pages 133-141 and 160-161.

94 Transcript of Evidence, page 133.

95 Ibid.

96 Ibid., page 161.

> All implications of a carrier's termination of lease agreements, whether planned or known early terminations, are reflected in access tariff filings via annual preparation of underlying access cost studies.[97]

During the hearing, Ms. Guthrie indicated that stranded investment associated with interLATA lease agreement terminations was not reflected in GTE's interLATA cost of service analysis, even though early terminations may have been known at the time the cost of service analysis was prepared.[98] Ms. Guthrie also indicated that these investments were not reflected in intraLATA toll or local service revenue requirements. When asked where these investments were reflected, Ms. Guthrie stated:

> As I understand this, and, once again, I am not an expert in this area, but if an investment is stranded, then it's, in effect, taken off the books. And I am not sure of the mechanism, but--[99]

Ms. Guthrie's testimony on this point is not clear. In any case, if GTE's access services tariff filing had been made in isolation without a concurrent general rate case,[100] Ms. Guthrie's testimony would be correct, at least to the extent that interLATA stranded investment would not be reflected in any revenue requirements. However, it is clear that because the rate base reflected in the general rate case is an end-of-period rate base, any investment associated with the provision of interLATA lease

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97 First Information Request of AT&T, item 12.

98 Transcript of Evidence, page 160.

99 Ibid., page 161.

100 Case No. 10117, Adjustment of Rates of GTE South, Inc.

agreements would be included in that rate base, even if particular interLATA lease agreements were known to be subject to termination in the near future.

Since stranded investment associated with interLATA lease agreements is not reflected in interLATA revenue requirements, the implication is that the investment is included in intraLATA toll or local service revenue requirement. This is not appropriate. Stranded investment associated with interLATA lease agreements that is not reassigned to other uses should be assigned to the interLATA market.

In summary, revenue requirements associated with interLATA lease agreements should be considered a part of access services revenue requirements, revenues associated with interLATA lease agreements should be considered a part of access services revenues, and stranded investment associated with interLATA lease agreements should be considered a part of access services revenue requirements. Furthermore, revenues associated with interLATA lease agreements should be included early termination payments.

Revenue Requirements

As a result of decisions discussed elsewhere in this Order, the Commission cannot authorize GTE an increased interLATA revenue requirement at this time. The record is clear that GTE's interLATA cost of service analysis omitted known FCC separations procedures changes and failed to fully reflect the impact of accounting rules changes.[101] Also, the record is clear that discrepancies exist between GTE's intrastate and interstate access services revenue requirements applications.[102] Finally, the record is ambiguous as to GTE's treatment of stranded interLATA investment.[103] The net result of these deficiencies is a misstatement of interLATA revenue requirements. Moreover, the record does not contain sufficient information for the Commission to make all necessary adjustments to restate GTE's interLATA revenue requirements.

On a related issue, in the Phase IV Order in Case No. 8838, the Commission established optional access services tariff filing procedures.[104] These procedures allow GTE and other local exchange carriers to make annual intrastate access services tariff filings that mirror their interstate access services tariffs as approved by the FCC to the maximum extent possible consistent with their revenue requirements and the Commission's regulatory policy goals of equity, efficiency, and universal service. Clearly, annual intrastate access services tariff filings that also involve applications for increased interLATA revenue requirements will not always coincide with general rate case applications. Therefore,

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101 Prefiled testimony of Ms. Guthrie, pages 3-4 and Brief of GTE, pages 12-13.

102 Prefiled testimony of Mr. Sather, page 22, Transcript of Evidence, pages 145-147, and Brief of AT&T, pages 8-9.

103 Transcript of Evidence, pages 160-161.

104 Order in Case No. 8838, Phase IV, pages 25-28, dated December 9, 1987.

the Commission will clarify annual access services tariff filing procedures to indicate that when such applications include an interLATA cost of service analysis to support increased interLATA revenue requirements, then an analysis of the impact of additional access services revenues on the local exchange carrier's earnings must be filed. Commonly, this is referred to as an absorption test. The absorption test should be based on a historical test period ending no later than 90 days prior to the date of any application for increased interLATA revenue requirements and should be adjusted for all changes in the local exchange carrier's most recent general rate case.

FINDINGS AND ORDERS

The Commission, having considered the evidence of record and being advised, is of the opinion and finds that:

1. GTE's access services tariff filing should be rejected.

2. GTE should be allowed to deviate from the annual access services tariff filing schedule and resubmit a 1988 application.

3. GTE's interLATA cost of service analysis should be rejected.

4. GTE's interLATA demand forecast and price-out should be rejected.

5. The rate of return on intrastate access services should mirror the rate of return on interstate access services.

6. Revenue requirement associated with interLATA lease agreements should be considered a part of access services revenue requirements.

7. Revenue, including early termination payments, associated with interLATA lease agreements should be considered a part of access services revenue.

8. Stranded investment associated with interLATA lease agreements should be considered a part of access services revenue requirement.

9. GTE's application for increased interLATA revenue requirements should be rejected.

Accordingly, each of the above findings is HEREBY ORDERED.

Done at Frankfort, Kentucky, this 1st day of August, 1988.

PUBLIC SERVICE COMMISSION

Richard D. Heman Jr.
Chairman

Robert M. Davis
Vice Chairman

James M. Williams
Commissioner

ATTEST:

Executive Director